TAX HAVENS AND HOW THEY WORK

PROFESSOR BARRY SPITZ

"DOIN' RIGHT"

It's a wellknown fact that people who squawk about their taxes may be divided into two classes. They are: men and women.

Over a span of three generations the Schmidt family had built up a mighty cosmetics empire and still managed to keep the stock tightly in the family's hands. The Schmidts had only one problem: none of them could afford to die. German inheritance tax would have forced a sale of stock worth more than many national budgets. An answer had to be found.

First I moved the Schmidts physically to tax havens -- Elke and her children to the Mediterranean, Walter and his family to the Caribbean, and Andrea who was a living advertisement for seventy years of using the family beauty products went to England, the best tax haven of them all. Then we moved the technology offshore. Not to Liechtenstein where the rights might not have been recognized in other countries, but to the Bahamas where a token factory could be set up. Finally we dealt with the children's and grandchildren's future tax problems through offshore trusts in Jersey. Now everyone could afford to die, but they still decided not to.

As it has been so elegantly phrased by the American Judge Learned Hand, "There is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right."

And so: welcome to the tax haven -- everyone's natural place of shelter from the blast of onshore taxation.

WHAT'S A TAX HAVEN?

It's a place where you pay no tax at all or much less tax than you would pay somewhere else. So nearly any country can be your tax haven. I have clients living more than ten months of the year in high-tax countries where they are legally designated as non-residents for tax purposes; others who are deemed residents in havens of convenience and who barely spend more than a couple of days there from time to time. Sometimes one spouse is a resident and the other not; though technically *separated* they manage to live together happily ever after.

An old adage proclaims that "the law is an ass". If so, tax law is an even bigger ass. With so much confusion, such inconsistencies, so many exceptions and special rules, it's no wonder that nearly anyone who knows the game well can turn the world into his tax haven. And most players don't even need to move and inch to do so.

We were setting up a Bermuda captive insurance company for a group of US heart surgeons to protect them against professional negligence suits, when one of them received a call giving him the exciting opportunity of putting through a sale in Florence of a master painting to a Japanese collector. If he had so done in his own name he'd have been subject to full US tax, but an offshore company taking offshore commissions isn't liable to tax at all. Half of our work was involved in setting up the deal; the other half was to make sure that he wasn't personally liable to tax in the US on the profits of his offshore company (which was what the Americans unaffectionately call a controlled foreign corporation) and that he could repatriate the bulk of the profits to the US. By structuring the commission so that it was in the right class of income and that the money he wanted back in the US came through a loan against the stock of the offshore company, the surgeon got his heart's delight.

The number of tax havens and the variety of types of tax havens and offshore situations are multiplying all the time. This is a fascinating and proliferating species. The term "offshore" was used originally to refer to the tax havens off the shores of the United Kingdom and the United States and by extension to any company or trust located in a tax haven or a country where tax can be kept low.

The classical tax havens generally have a common denominator of: no taxes on income and capital, bank and commercial secrecy, no exchange controls -- at least for offshore, an active banking sector, good communications, an appearance of political and economic stability, a favourable disposition towards foreign capital, and adequate professional advisers. The best havens of this type are the Bahamas, Bermuda and the Cayman Islands.

But because the tax haven business generates such big revenue, many other little countries, like the Channel Islands, Liechtenstein and the Netherlands Antilles, have staked claims to the tax haven industry by offering special tax incentives and privileges. And you can add to these again half of the islands in the Caribbean and a good representation of tropical paradises from the South Pacific and the Indian Ocean.

There's such a lot of offshore business around! So it's not particularly surprising that the major countries don't want to waste it all on the palm-tree economies, and are making a strong bid for their share of the action. Many of them offer very tempting packages. Like the British government giving Delorean some £80 million to set up his gull-wing car factory in Northern Ireland. If there's one thing better than paying no tax, it's paying negative tax: the government actually pays you. You only need to look at the fabulous tax deal you can get by putting your shipping operations in the US where the combination of credits and funds can give you below zero tax. The US has beaten Panama and Liberia at their own game.

There are probably as many tax haven possibilities as there are countries. High in the tax havens league you will find some very improbable candidates, like the United States, the United Kingdom, the Netherlands, Singapore, Switzerland. Their offshore products have unusual features, and they prefer to style themselves *finance centres* rather than tax havens. Though a rose by any other name...

IT'S GOOD TO BE A STAR

Bjorn Borg and Anthony Burgess weren't the first, and Boris Becker and Ringo Starr won't be the last. Monaco is full of musical, literary and sporting stars -- many of them earning very big bucks. And so are the other residential havens.

But it's not always good enough to put yourself in a country with no personal tax if the bulk of your earnings come from high tax countries.

François de Villiers didn't like paying Canadian tax on the profits from his recordings. So he moved his home to London and put his royalties in a Dutch company. The Dutch agreed to take a turn of barely 2% tax in exchange for letting him use their tax treaties. In this way his company pays no withholding taxes in the US, the UK, Germany, France or some 40 other countries. He pays the Dutch a bit of tax on the spread, and then moves the money straight out of Amsterdam to his account in Switzerland. Though he lives in London, he has no UK tax problems because of a quirk in the law. As long as he has at the back his mind the intention to go back to Canada someday, he's not considered *domiciled* in the UK, even if he lives there 365 days in the year. On this basis he doesn't pay any UK tax on his foreign income kept abroad.

François may have decided to emigrate, but a lot of stars don't. They just stay right where they are and treat their own countries like tax havens, often by turning their income into a capital appreciation in their own companies. This technique can work so well that companies have even been floated on the London Stock Exchange based on book earnings generated from the performances of their stars. Masters of this game were Tom Jones and the Beatles. And who could ask for better?

A lot of stars use an offshore company to employ them. The company makes the profits and pays them a salary spread over the years. But this ploy doesn't always work. Take what happened to Ingemar Johannson, the Swedish prize fighter. He had incorporated a Swiss company of which he was the sole employee and source of revenue; he was entitled to receive 70 percent of the company's gross income plus a pension fund. He then fought in the United States for the heavyweight boxing championship of the world, and was hit for taxes by the IRS. He claimed tax exemption under the Swiss-US Tax Treaty on the grounds that he and the company were really Swiss residents. That was one fight he well and truly lost. But for every loser there are a lot of winners.

WHAT DO THE TAX HAVENS OFFER?

The principal products stocked by the tax haven supermarkets are companies and trusts. Offshore companies usually hold investments and may get involved in trading. Offshore trusts protect the ownership of assets and frequently of the companies themselves. The true holders are usually individuals residing in high tax countries.

Offshore companies and trusts hold every imaginable kind of assets: real estate, art collections, jewellery, stocks and bonds, insurance policies, contingent claims, in fact anything at all.

Nor is offshore only for the very wealthy and the multinationals. Depending on what you want and which haven you use, an offshore company and trust don't need to cost all that much. A few thousand dollars initial outlay can usually take care of both.

OFFSHORE TRUSTS

The wonder product is the offshore trust.

The way the trust works is for the settlor to transfer assets to trustees who control the fund. This means that the trustees decide on the way in which the trust assets are invested and also on how the trust assets should be made available to the beneficiaries.

Carlos Davant hadn't come to the Caymans for a tan. He could get that at home. He came for an offshore trust and nearly took the first plane out when he learnt that he not only had to give his assets to the trust but that he also had to give some discretionary powers to the Cayman trustees. Carlos had made his fortune through property -- the true Eldorado of the investment world -- and he was absolutely clear in his mind that he wanted to have the benefits of a discretionary trust but still remain firmly in the driver's seat. Eventually, he relaxed when we explained to him that he only had to tell the trustees what he wanted and they would do just that. So he wrote the trustees a little letter of wishes asking them to follow all his instructions during his lifetime. He went away happy in the knowledge that he could modify his instructions whenever he wanted.

And we could then attend to the serious business of getting him an Irish passport and a Swiss residence permit. Carlos was especially happy to learn that many good residence possibilities and even second passports are available to those who know the law and procedure.

There are of course different sorts of trusts, and it's perfectly possible to have a settlement where all the income is paid as of right to the settlor and the trustees also have the power to give him the capital. Equally it is possible to have trusts where the settlor has no rights at all to any income and no rights at all to the capital. This is a very useful sort of trust for anyone planning to emigrate to the US.

Since its earliest origins in Medieval England the trust has been used to get around inconvenient rules of law. In those days when a knight died and left his property to his minor son, the lord of the manor would be entitled to use the heir's land for his own benefit until the youngster turned 21. The knights found an answer to this problem, and so: Enter the trust! On his deathbed wily Sir Edgar would convey the land to his friend, Sir Robert, to hold *to the use* of his son, Ethelred. In this way Ethelred would not become the legal owner, and the lord would be deprived of his feudal rights. Of course, Sir Edgar had to have confidence that Sir Robert would hand over the land when Ethelred turned 21. The point is that the trust lets one person be the legal owner and another the equitable owner.

This old-fashioned bit of tax avoidance worked so effectively that by the end of the last century the trust was well and truly in position to fulfil its prime vocation of income tax and estate tax avoidance. It has steadily maintained its place as the favoured tax game of the rich.

Inevitably, the trust became a target of British and American anti-avoidance measures. But since the moves to restrict the free operation of tax avoidance games were domestic, the wealthy had an easy riposte. They duly set up their trusts offshore: in the Channel Islands, Bermuda and the Carribean islands where the British Empire had carried the English law of trusts but not the British tax system. It was a long time before the high tax countries counterattacked offshore.

For the most part, it's the Anglo-Saxons that have the monopoly of the offshore trust business. But there's one contender which has done extraordinarily well with its own inventivity and marketing skills. That's of course Liechtenstein.

The most common and best known of the Liechtenstein entities is the anstalt, an establishment which is very easy to set up and administer. Its particular interest lies in the feature that the supreme authority of an anstalt is the holder of the founder's rights. These founder's rights are evidenced by a certificate which is often transferred from one person to another in blank. If Joe Flaum holds this certificate he has the approximate equivalent of a bearer share certificate for all of the shares of a company. He can simply change the anstalt's directors and the beneficiaries at will.

OFFSHORE COMPANIES

No-one can count the number of tax haven companies. They are put there for a very good reason: an offshore company can be used for any purpose for which a company in a high tax country can be used, and it doesn't pay tax. The bulk of offshore companies simply collect income consisting of dividends, loan interest or patent royalties and licence fees. But many are also used for business purposes. Handled correctly, the offshore company plays a turntable role using tax-exempt income to make more tax-exempt income.

Apart from tax, an offshore company can be used for other purposes such as privacy and freedom from exchange control, or to protect assets against future developments in the home country. History has played strange tricks on some of the greatest fortunes ever amassed.

Though companies in most tax havens offer basic similarities, there are useful differences. For example, what information must be contained in the bylaws, can the true promoters and beneficial owners be kept entirely out of the picture? What are the costs of incorporation, and time involved and can it be accelerated? Are there limits on the powers of the company? Is there any limitation of liability? Can there be bearer shares, no par value shares, preference shares, redeemable shares, shares with special rights?

Lee Han lives in Singapore and holds his US shares through a Guernsey company. A company doesn't die and so there'll be no US estate tax ever paid on those shares -- and there'll be no US probate either. For the same reason Johann van Heerden bought his Marbella villa through a Cayman company and not in his own name.

OFFSHORE BANKING

A huge volume of international banking takes place offshore. Indeed it is extremely very easy for an individual or a company to open a bank account offshore, and even numbered accounts are not complicated.

In most countries one of the terms of the relationship between banker and customer is that the banker will keep the customer's affairs secret. In tax havens this rule is sometimes widened and made a marketing feature, for instance the elaborate bank secrecy regulations in the Bahamas and the Cayman Islands. The funny side of these regulations is that they are so complicated that a lot of banks and trust companies require all clients to sign form waivers.

On the other hand, Switzerland, which has traditionally been the world's guardian of bank secrecy, is slowly moving towards greater openness. But this has been very good for banking business in Austria.

SOME OTHER TAX HAVEN SPECIALITIES

Other products on the shelves of the offshore supermarkets are: finance subsidiaries, captive banks, captive insurance companies, shipping and transhipment companies, licensing companies, headquarters companies, management services companies, manufacturing and export bases, and tax shelters.

Sven Thordsen thought he had found paradise on earth when he came to Costa Rica and invested the savings of his stockbroking career in a lobster farm on the Mexican Gulf. The Costa Ricans welcomed him as an immigré with a lifetime tax exemption and gave the same treatment to his lobsters. They all prospered, and Sven built up a crustacean empire to the gastronomic delight of Northern Europe and Japan. Soon he diversified and moved into the multinational game. The structure of his group began to look like a scrabble board of companies and operations. Like all multinationals, he needed a finance subsidiary and I put this in the Cayman Islands, only one hour away. For the shipping and container company we looked at Panama which was near but we didn't feel secure with its politics; so we went for Liberia. Sven was specially pleased to be able to run the Liberian operations out of New York and not Liberia. For his headquarters company I chose Paris where the French gave him as good a tax deal as any tax haven could, as well as a classy address and image. International sales were handled through a number of tax haven branches of a Swiss company. Licensing flowed smoothly through a Dutch company taking advantage of the worldwide tax treaty network. The total tax bill on worldwide profits of the group came to under 4 percent.

With split salaries and payrolls, and by transplanting pension and stock option schemes, even the onshore executives and sales staff enjoyed offshore tax treatment.

Psst! Who was it again that said it was against the religion of multinationals to pay tax?

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